

December 18, 2020

Ms. Vanessa A. Countryman  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549

Re: File Reference No. PCAOB–2020–01

**SEC Release No. 34–90473, Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on Amendments to PCAOB Interim Independence Standards and PCAOB Rules To Align With Amendments to Rule 2–01 of Regulation S–X**

Dear Ms. Countryman:

With respect to the PCAOB’s adoption of certain amendments to its independence standards (PCAOB Release No. 2020-003), a number of comment letters provided to the Securities and Exchange Commission have referenced a statement that I made at the time a majority of the Board approved these changes.

I am, therefore, attaching a copy of that statement (*available at <https://pcaobus.org/news-events/speeches/speech-detail/reducing-pcaob-authority-over-auditor-independence>*) for completeness of the Commission’s comment file.<sup>1</sup>

Respectfully submitted,



J. Robert Brown, Jr.

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<sup>1</sup> The views expressed are mine alone and may not reflect the views of my fellow Board members or the staff of the PCAOB.

## Reducing PCAOB Authority over Auditor Independence

Date: Nov. 19, 2020  
Speaker: J. Robert Brown, Jr.  
Event: PCAOB Open Meeting  
Location: Virtual

Today, we are considering amendments to our standards and rules on auditor independence.<sup>2</sup>

For over 150 years, the auditing profession has served as a gatekeeper for the financial disclosure process. At its core, the integrity of the audit has always depended upon an exacting standard of independence between audit firms and their clients.

In the wake of Enron and other corporate accounting scandals, investor confidence in that gatekeeper role of auditors evaporated. Auditor independence had eroded, placing the objectivity of audit firms and the reliability of audits in doubt.<sup>3</sup> To address the concerns, Congress created a strong, independent regulator that would “further the public interest in the preparation of informative, accurate, and **independent** audit reports.”<sup>4</sup>

Recognizing the critical importance of auditor independence,<sup>5</sup> the PCAOB was given explicit authority to develop its own standards governing auditor independence and to make its

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<sup>2</sup> Today’s release adopts amendments to the PCAOB’s interim auditing standards and Part 5 of the Rules of the Board, subject to approval by the U.S. Securities and Exchange Commission (SEC or Commission). See PCAOB Release No. 2020-003, PCAOB Rulemaking Document Matter No. 047 (“Release”) (Nov. 19, 2020). I want to thank Clara Fryer, an intern in my office during the fall of 2020, for her valuable work on this statement.

<sup>3</sup> See *Accounting Reform and Investor Protection, Hearings Before the S. Comm. on Banking, Hous., and Urban Aff.*, 107th Cong. (Feb. 12, 2002) (Statement by Senator Shelby) (“Regrettably, Mr. Chairman, growing doubt is replacing investor confidence regarding the accuracy of financial information. The trend of restatements and audit failures has put the independence and objectivity of outside auditors in question. In far too many cases, the numbers have just not added up.”).

<sup>4</sup> 15 U.S.C. §7211(a) (emphasis added). After a series of financial reporting scandals that severely impacted the financial markets, the Sarbanes-Oxley Act (SOX or the Act) was signed into law by President George Bush on July 30, 2002, following passage by an overwhelming majority in the US Senate and House of Representatives, in order to restore public confidence in the reliability of financial reporting.

<sup>5</sup> “The issue of auditor independence is at the center of this legislation. Public confidence in the integrity of financial statements of publicly-traded companies is based on belief in the independence of the auditor from the audit client.” S. REP. NO. 107-205 (200) (available at <https://www.govinfo.gov/content/pkg/CRPT-107srpt205/html/CRPT-107srpt205.htm>); see also 148 CONG. REC. S6332 (2002) (Statement by Senator Sarbanes) (quoting David Walker, Comptroller General of the US) (available at <https://www.govinfo.gov/content/pkg/CREC-2002-07-08/html/CREC-2002-07-08-pt1-PgS6327-7.htm>) (“History has shown that the AICPA and the SEC have failed to update their independence standards in a timely fashion and that past updates have not adequately protected the public’s interests.”).

own determinations as to what they should include.<sup>6</sup> Congress expected the PCAOB to use its authority to set standards, to examine audit firms' compliance with rules and standards, and to investigate and bring disciplinary action for matters relating to independence and the integrity of the audit.

Today, however, the Board is rolling back the auditor independence rules of the PCAOB without conducting its own economic or policy analysis.<sup>7</sup> The approach effectively cedes away much of the PCAOB's distinct and separate authority over independence standards.<sup>8</sup> The majority does so without public input or discussion.

The Board is also adopting these changes in a rushed manner that comes at considerable cost.

Investors, audit firms, audit committees, and the public are being denied a right to participate in amendments to the PCAOB's independence standards.<sup>9</sup> The PCAOB has done this

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<sup>6</sup> The Act provides the Board with broad authority to establish independence and ethics requirements for auditors of public companies, brokers, and dealers "as may be necessary or appropriate in the public interest or for the protection of investors." Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 and 18 U.S.C.). In 2003, the PCAOB adopted interim independence standards based on the AICPA Code of Conduct and the Independence Standards Board. See Establishment of Interim Professional Auditing Standards, PCAOB Release No. 2003-006 (Apr. 18, 2003) (available at [https://pcaobus.org/Rulemaking/Interim\\_Standards/Release2003-006.pdf](https://pcaobus.org/Rulemaking/Interim_Standards/Release2003-006.pdf)). In doing so, the Board made clear that these standards did not supersede SEC standards and, where the two sets of standards were inconsistent, the more restrictive standard would apply. In 2006, the PCAOB adopted additional independence rules related primarily to tax services. See PCAOB, AS 1005: Independence; Rule 3520, Auditor Independence; Rule 3524, Audit Committee Pre-Approval of Certain Tax Services; Rule 3525, Audit Committee Pre-approval of Non-audit Services Related to Internal Control over Financial Reporting; Rule 3526, Communication with Audit Committees Concerning Independence, ET Section 101 – Independence (available at <https://pcaobus.org/standards>).

<sup>7</sup> In adopting today's amendments to the interim independence standards, the release mostly "took notice" of the process used by the SEC in adopting amendments to Rule 2-01, 17 C.F.R. §210.2-01, in Regulation S-X. The PCAOB Release notes that the Board "took notice" of the Commission's "regulatory process," the Commission's "rulemaking process," the Commission's "analysis of the parties that would be affected by the SEC's amendments," analysis of "certain potential benefits" and "potential costs and other consequences" identified by the Commission when amending Rule 2-01 in 2019 and 2020, and the "Commission's observation...that the SEC's" amendments to Rule 2-01 "could result in some crowding-out effect in the audit industry." See Release, *supra* note 1.

<sup>8</sup> The Board recognizes that it may need to revisit these decisions. *Id.* ("If the Board were to determine at a future date that diverging from the SEC's approach to lending arrangements is necessary or appropriate in the public interest or for the protection of investors, the Board retains the authority under the Act to do so.").

<sup>9</sup> The last time that the PCAOB did not seek comments on changes to standards was in 2004 and in very different and highly exigent circumstances. See Docket 016: Temporary Transitional Rule Relating to PCAOB Auditing Standard No. 2. PCAOB (available at <https://pcaobus.org/Rulemaking/Pages/Docket016.aspx>). The PCAOB did so only for a "temporary transitional" provision where exigent circumstances made public comment impracticable. See Temporary Transitional Rule Relating to PCAOB Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements, PCAOB Release No. 2004-014 (Nov. 30, 2004) (available at [https://pcaobus.org/Rulemaking/Docket016/2004-11-30\\_Release\\_2004-014.pdf](https://pcaobus.org/Rulemaking/Docket016/2004-11-30_Release_2004-014.pdf)) ("The Board's practice is to seek, whenever practicable, public comment prior to adopting a rule and submitting it to the Commission for approval. The Board has determined that this is the unusual case in which public comment is not practicable, in light of the imminence of the filing requirements at issue.").

by forgoing the usual and expected process of subjecting its proposed standards to public comment.<sup>10</sup> The decision to dispense with the views of investors, audit committees, audit firms, and the public does not comport with the PCAOB's mission,<sup>11</sup> is not compelled by exigent circumstances,<sup>12</sup> and is another example of an unfortunate trend of reducing investor and public input in the PCAOB decision-making process.<sup>13</sup>

The hurried nature of these actions also means that the Board is not adequately considering the impact of these changes on audit committees and on its own role in auditor oversight, a failure that will likely generate confusion and uncertainty in its wake.

Audit committees oversee auditor independence. There may be no more important task assigned to these directors.<sup>14</sup>

Recognizing this, the rules of the PCAOB require that audit firms continually evaluate their independence and communicate to audit committees any relationship that may bear on this issue.<sup>15</sup> The changes considered today will allow audit firms under the PCAOB's rules to engage

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<sup>10</sup> This also occurred recently with respect to the adoption of changes to rules and bylaws related to the administration of the PCAOB. *See Docket 045: Bylaw and Rule Amendments to Provide that the PCAOB's Appointment and Removal of its Hearing Officers are Subject to Commission Approval*, PCAOB (available at <https://pcaobus.org/Rulemaking/Pages/docket-045-bylaw-rule-amendments-appointment-removal-hearing-officers-subject-commission-approval.aspx>) ("The amendments that the Board is adopting today are concerned solely with the administration of the PCAOB. In particular, they relate to the PCAOB's employment relationship with its hearing officers, the PCAOB's interaction with the Commission in the Commission's performance of oversight of the PCAOB, and the clarification of the delegations of authority by the Board to PCAOB hearing officers. Therefore, the Board believes that public notice and comment in advance of adopting these bylaw and rule amendments is not required.").

<sup>11</sup> *See* 15 U.S.C. §7211(a) (mission of the PCAOB is "to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports").

<sup>12</sup> *See supra* note 8.

<sup>13</sup> Nor is time pressure a justification for this approach. The changes the PCAOB makes today will not be effective until April of 2021 when the most recent changes by the SEC go into effect. *See* Release, *supra* note 1. This provides plenty of time to collect and react to investor comment.

<sup>14</sup> *See* SEC, Chairman Jay Clayton, Chief Accountant Sagar Teotia, & Director of Division of Corporation Finance William Hinman, Statement on Role of Audit Committees in Financial Reporting and Key Reminders Regarding Oversight Responsibilities (Dec. 30, 2019) (available at <https://www.sec.gov/news/public-statement/statement-role-audit-committees-financial-reporting#:~:text=The%20audit%20committee%20plays%20a,of%20the%20company's%20independent%20auditor>) ("Compliance with auditor independence rules is a shared responsibility of the audit firm, the issuer and its audit committee. The audit committee plays a critical role in auditors' compliance with the auditor independence rules, in part because the Sarbanes-Oxley Act mandates that audit committees be directly responsible for the oversight of the engagement of the company's independent auditor.").

<sup>15</sup> *See supra* note 5.

in an expanded set of services to some affiliates of their audit clients.<sup>16</sup> They will also allow certain “inadvertent” violations of auditor independence requirements.<sup>17</sup>

The Board is silent about what, if anything, and when, if ever, audit firms should communicate these matters to audit committees. The result may be that directors will not receive information highly relevant to their oversight responsibilities.

With respect to PCAOB oversight, the PCAOB has a unique and fundamental role in assessing compliance with independence requirements. The PCAOB can, during the inspection process, assess risks to objectivity and impartiality as well as auditors’ compliance with federal regulations and PCAOB standards and rules. The ability to conduct this assessment may be compromised where firms do not adequately document their determinations.

The topic of documentation is missing from what the majority approves today. Nothing in the release speaks to whether firms should document their assessment of, and conclusions about, the immateriality of client affiliates, the effect of such a determination on a firm’s risk assessment, their determination that an independence violation was “inadvertent” or that an “inadvertent” violation could not be addressed prior to the client merger.<sup>18</sup>

The decision to forego public comment will not make these issues go away – rather they may become more pronounced.<sup>19</sup> As soon as these changes become effective, audit committees and audit firms will confront the confusion that will almost certainly arise from unexplained effects on the communication requirements. Inspection teams will struggle the uncertainties over

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<sup>16</sup> As the SEC has noted, these services can still deprive a firm of its independence. *See* Qualifications of Accountants, Exchange Act Release No. 34-90210, File No. S7-26-19 (Oct. 16, 2020) (*available at* <https://www.sec.gov/rules/final/2020/33-10876.pdf>) (“the auditor’s non-audit services to and relationships with sister entities that are no longer deemed affiliates as a result of applying the dual materiality threshold will continue to be subject to the principles set forth in Rule 2-01(b), and as such, knowledge of services to and relationships with such non-affiliate sister entities will be needed to sufficiently consider the general standard.”).

<sup>17</sup> The changes considered today do not specifically amend the rules of the PCAOB to address “inadvertent” violations. Nonetheless, the release takes the position that the violations will not impair independence. *See* Release, *supra* note 1 (“Pending further action, however, the Board generally would not expect to consider an accounting firm’s independence impaired solely because an audit client engages in a merger or acquisition that gives rise to a relationship or service that is inconsistent with the Board’s independence rules, provided that the firm has satisfied all the conditions in Rule 2-01(e).”).

<sup>18</sup> *See* Qualifications of Accountants, Exchange Act Release No. 90210 (Oct. 16, 2020) (*available at* <https://www.sec.gov/rules/final/2020/33-10876.pdf>) (“We expect that the independence-impairing service or relationship, in most instances, should and could be addressed before the effective date of the merger or acquisition. However, we understand there may be situations where it might not be possible for the audit client and the auditor to transition the independence-impairing service or relationship in an orderly manner without causing significant disruption to the audit client. In those situations, we expect the relationship or service to be addressed promptly after the effective date of the merger or acquisition.”).

<sup>19</sup> For a list of some possible questions, *see* Appendix. Investors and the public often have very different ideas with respect to standards. *See* J. Robert Brown, Jr., Board Member, PCAOB, PCAOB 3.0: The Evolving Role of Investor Protection at the PCAOB, 50th World Continuous Auditing & Reporting Symposium, Virtual, at n. 6 (Nov. 6, 2020) (*available at* <https://pcaobus.org/News/Speech/Pages/Brown-PCAOB-3-0-Evolving-Role-Investor-Protection-PCAOB.aspx>).

the unexplained expectations with respect to documentation requirements and the impact on assessing compliance.

Finally, these amendments largely leave untouched the out-of-date “interim” independence standards that the PCAOB adopted in 2003.<sup>20</sup>

The PCAOB adopted the audit profession’s standards as a starting point when it opened its doors. Those standards were written in the era of self-regulation without adequate investor input. The failure to modernize the “interim” independence standards and the related ethics rules gives new meaning to the term “interim” as the PCAOB approaches the beginning of the 18<sup>th</sup> year of these “interim” requirements.<sup>21</sup>

The majority’s action are inconsistent with what Congress intended, does not meet the expectations of investors, the public and audit committees, and fails to address the particular needs of the PCAOB in overseeing auditor independence. Audit firms and audit committees will be forced to address the consequences of the rushed rulemaking process and the failure to address the broader array of issues.<sup>22</sup>

This unprecedented approach should trouble audit firms, investors, and the public.<sup>23</sup> The PCAOB is obligated to act in the public interest. This is not a choice. The mission is set out in the statute with unmistakable clarity.<sup>24</sup> The PCAOB cannot simultaneously claim to adhere to this mission while failing to communicate with, and seek input from, investors and the public.

For these reasons, among others, I cannot support these amendments.

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<sup>20</sup> By not seeking public comment, the PCAOB also avoids the error correction and drafting assistance that often occurs through a public vetting process. Amending standards can be an art rather than a science. The PCAOB benefits from public input by receiving comments that can help avoid mistakes or provide better alternatives. *See infra* note 20. That assistance is made unavailable by the approach taken by the Board.

<sup>21</sup> Other policy decisions warrant public comment. For example, the amendments sometimes do not seek to “conform” PCAOB rules with those of the SEC but to instead simply remove overlapping provisions. *See Release, supra* note 1. (“Removing the provisions relating to lending arrangements from the Board’s interim independence standards, rather than making specific amendments to conform them to the SEC’s amendments to Rule 2-01, avoids duplicative Board and SEC independence requirements on lending arrangements and helps facilitate compliance with Rule 2-01, as amended, by clarifying a firm’s professional obligations.”). Commenters might view conforming changes more appropriate than removal.

<sup>22</sup> The Release notes that the application of the dual materiality threshold in the determination of “affiliate of the audit client” and “investment company complex” is novel and may “require audit firms and audit clients to familiarize themselves with and apply the...requirements.” *Id.*

<sup>23</sup>

*Id.*

Appendix:  
Possible Questions for Public Comment

- Should the PCAOB's rules specify documentation that auditor's should prepare and maintain when additional services are provided to affiliates of an audit client?
- Should the PCAOB consider rules or standards to address the "dual materiality threshold" when audit firms determine whether non-audit or advisory services can be provided to the "affiliate of the audit client" and/or the "investment company complex"?
- Should the PCAOB modify its standards or rules regarding the nature, timing, or extent of an auditor's duty to communicate with audit committee in light of these amendments?
- Should the PCAOB require auditors to document the nature and extent of any "inadvertent violations" of the independence standards?
- Should the PCAOB require audit firms to notify audit committees when inadvertent independence violations are "triggered" as a result of a client merger and whether or not such "violations" are "promptly" cured?